Evaluating Your Retirement Options

As an employee of a public school, you likely have access to both a pension and a retirement savings plan called a "403(b)" plan. Let's examine what a 403(b) plan is, and then go through the choices you'll likely need to make if you decide to invest in a 403(b) plan.

What Is a 403(b) Plan?

A 403(b) plan is a type of tax-deferred retirement savings program that is available to employees of public schools, employees of certain non-profit entities, and some members of the clergy. Because you do not have to pay taxes on the amount you contribute to a 403(b) plan for the year in which you contributed to the plan, investing in a 403(b) plan can lower your overall tax burden — at least in the present. You can defer the income tax on your contributions until you begin making withdrawals from your account — typically after you retire. The earnings on your account also grow tax-free until withdrawal.

Investment Options

If you are eligible to participate in a 403(b) plan, you may have to choose among different types of investments, depending on how your employer structures the plan. It will be up to you to choose investments that will best meet your financial objectives. 403(b) plans typically offer fixed annuities, variable annuities, and mutual funds. Here is a brief description of each:

Fixed Annuities are contracts with insurance companies that guarantee that you will earn a minimum rate of interest during the time that your account is growing. The insurance company also guarantees that the periodic payments will be a guaranteed amount per dollar in your account. These periodic payments may last for a definite period, such as 20 years, or an indefinite period, such as your lifetime or the lifetime of you and your spouse.

Equity Indexed Annuities are a special type of contract between you and an insurance company. During the accumulation period — when you make either a lump sum payment or a series of payments — the insurance company credits you with a return that is based on changes in an equity index, such as the S&P 500 Composite Stock Price Index. The insurance company typically guarantees a minimum return. Guaranteed minimum return rates vary. After the accumulation period, the insurance company will make periodic payments to you under the terms of your contract, unless you choose to receive your contract value in a lump sum. For more information, please see our "Fast Answer" on Equity Indexed Annuities available on www.sec.gov, and read FINRA's investor alert entitled Equity-Indexed Annuities — A Complex Choice available on www.finra.org.

Variable Annuities are contracts with insurance companies under which you make a lump-sum payment or series of payments into a tax deferred account. In return, the insurer agrees to make periodic payments to you beginning immediately or at some future date. You can choose to invest your purchase payments in a range of investment options, which are typically mutual funds. The value of your account in a variable annuity will vary, depending on the performance of the investment options you have chosen.

Tip: Make sure that the features you're buying when you invest in a variable annuity are worth the money you're paying. If you invest in a variable annuity through a tax-advantaged retirement plan (such as a 403(b) plan), be aware that you receive no additional tax advantage from the variable annuity. Investors typically pay for each benefit provided by any given product. Be sure you understand the impact of these costs and all others fees and expenses.

Mutual Funds are companies that pool money from many investors and invest the money in stocks, bonds, short-term money-market instruments, or other securities. Mutual funds come in many varieties. For example, there are index funds, stock funds, bond funds, money market funds, and more. Each of these may have a different investment objective and strategy and a different investment portfolio. Different mutual funds are subject to different risks, volatility, and fees and expenses.

What Questions Should I Ask About My Investment Choices?

The best tip we can give on how to invest wisely boils down to two words: ask questions. Over the years, we've seen far too many investors who suffered avoidable losses because they didn't ask basic questions from the start.

Although you may be eligible to participate in a 403(b) plan, don't assume that your employer has checked out or approved any particular investment product or any firm or professional that sells potential 403(b) investments. School districts typically do not engage in that sort of screening, and some states prevent school districts from limiting the companies that can sell 403(b) plan investments. That's why it's so important to do some homework on your own to assure yourself that the choices you make are the best for you in light of your personal circumstances and financial objectives.

For starters, be sure to ask at least the following three key questions:

Will I have to pay any penalties if I change my investment choices? If so, how much?

Make sure you know the answer to this critically important question before you make your investment choices. The answer will depend on the type of product you initially chose and when you purchased that product in your account. For example, if you withdraw money from a variable annuity within a certain period after a purchase payment (typically within six to eight years, but sometimes as long as ten years), the insurance company usually will assess a "surrender" charge.

A surrender charge is a type of sales charge that compensates the financial professional who sold the variable annuity to you. Generally, the surrender charge is a percentage of the amount you sell or exchange, and it will decline gradually over a period of several years, known as the "surrender period." For example, a 7% charge might apply in the first year after a purchase payment, 6% in the second year, 5% in the third year, and so on until the eighth year, when the surrender charge no longer applies. Some variable annuity contracts will allow you to withdraw part of your account value each year — 10% or 15% of your account value, for example — without paying a surrender charge.

Some mutual funds have a back-end sales load known as a "contingent deferred sales load" (also referred to as a "CDSC" or "CDSL"). Like a surrender charge for a variable annuity, the amount of this type of load will depend on how long the investor holds his or her shares, and it typically decreases to zero if the investor holds his or her shares long enough. The rate at which this fee will decline is disclosed in the fund's prospectus.

A redemption fee is another type of fee that some funds charge their shareholders when the shareholders redeem their shares. Although a redemption fee is deducted from redemption proceeds just like a deferred sales load, it is not considered to be a sales load. Unlike a sales load, a redemption fee is typically used to defray fund costs associated with a shareholder's redemption and is paid directly to the fund, not to a broker. The SEC generally limits redemption fees to 2%.

> Note: The question of whether you must pay a penalty or other fees for switching among investment choices in your plan is completely different from whether you must pay a penalty for taking money out of your 403(b). The tax laws generally impose penalties for early withdrawals from tax-deferred retirement plans, such as 403(b) plans, IRAs, and 401(k)s. Before you take money out of your 403(b) account, be sure to consult with a tax adviser.

What annual fees will I pay?

As you might expect, fees and expenses vary from product to product — and they can take a huge bite out of your returns. An investment with high costs must perform better than a low-cost investment in order to generate the same returns for you. Even small differences in fees can translate into large differences in returns over time.

For example, if you invested $10,000 in a product that produced a 10% annual return before expenses and had annual operating expenses of 1.5%, then after 20 years you would have roughly $49,725. But if the investment had expenses of only 0.5%, then you would end up with $60,858 — an 18% difference.

For mutual funds and variable annuities, you can find information on costs and fees in the prospectuses. For fixed annuities, check the sales literature or the contract.

Does my financial professional make more money for selling one product over another?

Regardless of how much you trust your financial professional, it is always legitimate to ask how - and how much - he or she receives for selling a particular product. For example, you could ask the following:

- Do you receive a commission for selling Product X to me? If so, how much?
- Do you get any other type of compensation for selling Product X? If so, what? (This could include a bonus or points toward some other reward, such as a trip or a cruise.)
- Do you get more for selling Product X over Product Y?
- Are there any other products that can meet my financial objectives at a lower cost to me (even if you do not sell those products)?

It will be critical for you to know in advance which products can best meet your financial objectives and to identify a financial professional who sells those products. Different types of financial professionals sell different types of products, and some financial professionals will offer only a limited number of choices. When deciding what's best for you, shop around for the best fit. When brokers or insurance salespersons stand to earn more money for selling Product X over Product Y, they have a natural incentive to steer you toward Product X — even if Product Y might ultimately be a better choice for you.

For More Information

For more information about the types of products available through 403(b) plans, please read the following SEC publications available at www.sec.gov:

- Equity-Indexed Annuities — Describes key features of equity-indexed annuities, including indexing methods and interest rate calculation.
- Variable Annuities: What You Should Know — More information about variable annuities, including the bonus credits, transfer issues, and fees.
- Invest Wisely: An Introduction to Mutual Funds — Basic information about investing in mutual funds. Much of this information applies to variable annuities, as well.
- Mutual Fund Investing: Look at More Than a Fund's Past Performance — Describes some of the factors you should consider in choosing a mutual fund.

Where to Find Help with Questions or Complaints

If you have a problem with investments in your 403(b) plan, you may want to turn to several sources for help. We always welcome hearing from you. Here's how you contact us:

Office of Investor Education and Advocacy
U.S. Securities and Exchange Commission

(800) 732-0300
www.investor.gov

If the problem involves a product that we don't regulate (such as fixed annuities and many equity-indexed annuities), you should contact your state insurance commissioner.

SEC Pub. No. 033 (4/10)